

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
A. CHARLES CINELLI	:	DETERMINATION
D/B/A SHOPORAMA CAR WASH	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period September 1, 1980	:	
through May 31, 1983.	:	

Petitioner, A. Charles Cinelli d/b/a Shoporama Car Wash, 1307 Altamont Avenue, Schenectady, New York 12303, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1980 through May 31, 1983 (File No. 802576).

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Building #9, W. A. Harriman State Office Campus, Albany, New York, on September 22, 1987 at 9:15 A.M., with all briefs to be filed by February 26, 1988. Petitioner appeared by DeGraff, Foy, Conway, Holt-Harris and Mealey (James H. Tully, Jr., Esq., of counsel). The Audit Division appeared by William F. Collins, Esq. (Thomas C. Sacca, Esq., of counsel).

ISSUES

I. Whether petitioner has established that the amount of sales tax assessed was erroneous or that the method of audit was unreasonable.

II. Whether the Division of Taxation established that petitioner's failure to accurately report and pay over sales taxes was due to fraud.

FINDINGS OF FACT

1. On August 13, 1985, the Division of Taxation ("Division") issued to petitioner, A. Charles Cinelli d/b/a Shoporama Car Wash, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period September 1, 1980 through May 31, 1983, assessing sales tax in the amount of \$408,997.31, plus a fraud penalty of \$204,498.67 and interest of \$225,553.75, for a total due of \$839,049.73.

2. Petitioner executed four consents which taken together extended the period of limitation for assessment of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1980 through May 31, 1982 to September 20, 1985.

3. The Division conducted an audit of petitioner's business for the period September 1, 1980 through May 31, 1983.

(a) Throughout the audit period, petitioner owned and operated a combination gasoline

station, car wash and small convenience store. There were approximately 25 gasoline pumps on the premises.

(b) The auditor initially contacted Mr. Cinelli who directed the auditor to contact his accountant, Fred Freedman. The auditor requested and received from Mr. Freedman: petitioner's sales tax returns for the audit period including related worksheets; petitioner's 1980, 1981 and 1982 Federal income tax returns with related workpapers and depreciation schedules; a sales journal; a check disbursements journal; purchase invoices; and cancelled checks. No records were requested which were not provided, and those provided were deemed to be in good condition.

(c) Gross sales as shown on petitioner's quarterly sales tax returns were compared to gross sales as shown on petitioner's books with only minor discrepancies noted.

(d) The names of petitioner's gasoline suppliers were gleaned from the gasoline purchase invoices. All gasoline suppliers were contacted, and each was asked to provide the Division with a record of all sales of gasoline, oil and related products made by the supplier to petitioner. Petitioner's records showed total gasoline purchases for the audit period of 2,803,844 gallons. Petitioner's suppliers reported that petitioner had purchased a total of 12,164,491 gallons of gasoline during the audit period.

(e) The auditor obtained petitioner's average monthly gasoline selling prices from advertisements placed in a local newspaper. These selling prices were adjusted for excise and sales tax included in the price, and the results were applied to audited gasoline purchases to obtain audited taxable gasoline sales of \$12,693,959.88 for the audit period.

(f) Using petitioner's records and third-party verification of purchases from other vendors, the auditor estimated taxable sales of such items as cigarettes, kerosene and diesel fuel of \$2,835,838.90. This was added to audited gasoline sales to obtain total audited sales of \$15,529,798.68. Audited sales were reduced by reported sales, resulting in additional taxable sales of \$10,019,932.68 with a tax due on that amount of \$400,797.25.

(g) A review of petitioner's purchases disclosed capital expenditures during the audit period of \$205,001.59 with a tax due on these purchases of \$8,200.06. This was added to sales taxes due to determine total tax due for the audit period of \$408,997.31.

4. After reviewing evidence presented by petitioner at a Tax Appeals conference, the Division adjusted its calculation of tax due and at hearing asserted a tax liability of \$354,347.83. The reduction represents adjustments made to audited cigarette, kerosene and miscellaneous sales and a determination that tax due on purchases of capital assets amounted to \$717.83.

5. On or about June 26, 1985, petitioner was indicted on eight counts of offering a false instrument for filing in the first degree, in violation of Penal Law § 175.35. The eight counts in the indictment corresponded to the first eight quarters of the eleven-quarter audit period.

6. On March 27, 1986, petitioner pleaded guilty to offering a written instrument for filing, with intent to defraud the State of New York, namely, filing a quarterly sales tax return for the period ended May 31, 1981 while knowing that the written instrument contained a false statement and false information, i.e., the amount of gross sales was understated. Petitioner's plea was accepted in satisfaction of all eight counts of the indictment. He was sentenced to three months in the county jail and five years' probation, fined \$25,000.00 and ordered to pay

restitution to the State.

7. At petitioner's hearing on his plea, the following exchange took place:

"THE COURT: All right, Mr. Cinelli, you made it a practice, did you not, of getting all the documentation and all the information necessary for your accountant to file the quarterly sales tax return to the accountant, you were the genesis of all that information; that is correct?

THE DEFENDANT: Yes.

THE COURT: He didn't work in the gas station there and compile figures, you gave him all the figures that you deemed necessary for him to file this quarterly sales tax return; is that correct?

THE DEFENDANT: Yes.

THE COURT: And for that period of time you gave him certain information and you gave him certain documentation, upon which he made that quarterly sales tax return; is that correct?

THE DEFENDANT: Yes, sir.

THE COURT: And you knew for that period of time that you were understating what your business was during that period of time, so that you knew that based upon the information that you gave him for that quarter that he was going to understate your sales tax liability; that is correct, sir?

THE DEFENDANT: The material was incomplete, yes.

THE COURT: All right. And the purpose that it was incomplete is so that there would be somewhat of a lesser figure on the quarterly sales tax return and all the sales tax due and owing to the State of New York would not be paid; is that correct, sir?

THE DEFENDANT: Yes.

THE COURT: And that is the same with all these other counts; is that correct?

THE DEFENDANT: Yes.

* * *

THE COURT: You knew as a result of the activity that you engaged in, by not giving him all of the information he needed, that that quarterly sales tax return would be understated with respect to your tax liability; that is correct?

THE DEFENDANT: Yes."

8. Shortly before entering the guilty plea, Mr. Cinelli was hospitalized for a suspected cardiac condition. He was diagnosed as having hypertension controlled by medication. He was referred to the Behavioral Medicine Clinic of Schenectady for psychiatric evaluation and treatment. In written reports, his medical doctors made these observations: that Mr. Cinelli suffered from depression and suicidal thoughts; that he had difficulty in communicating with other people; that Mr. Cinelli had impairments of memory and concentration; and that he suffered periods of acute anxiety. Mr. Cinelli was treated with psychotropic medications as well as medications to control hypertension.

9. Mr. Cinelli had no formal education beyond high school. The business which was the subject of the audit was begun as a car wash in 1970 and later expanded to include a gas station and a convenience store. At the outset of the business, Mr. Cinelli hired Fred Freedman to act as his accountant. Mr. Freedman worked for Mr. Cinelli for 13 years.

10. Mr. Cinelli's wife was responsible for maintaining the daily records of the business in her home office. At the beginning and end of each day, Mr. Cinelli or an employee recorded readings from the gasoline pump meters. This provided a record of the number of gallons of gasoline sold each day. From these daily sheets, Mrs. Cinelli prepared a monthly summary.

11. At the end of each month, Mrs. Cinelli provided Mr. Freedman with purchase receipts, i.e., bills of lading, invoices and delivery tickets; the monthly summary of meter readings; bank statements and the business checkbook, including five endorsed checks.

12. From the records provided by Mrs. Cinelli, Mr. Freedman's bookkeeper computed the tax due and prepared the quarterly sales tax return. She signed Mr. Cinelli's name to the returns and submitted them to the Division without Mr. Cinelli's review. Mr. Freedman returned some or all of the materials used to prepare the returns to Mrs. Cinelli.

13. In October 1983, petitioner engaged the services of International Software to provide him with a computerized recordkeeping and accounting system. After setting up a basic general ledger, payroll and inventory system, the computer salesperson, Kathleen Raeihle, asked to see petitioner's records for back years. Petitioner had available receipts, invoices and other source documents for 1983. He referred Ms. Raeihle to Mr. Freedman for any other records she might need.

14. Mr. Freedman provided Ms. Raeihle with the monthly summary sheets for 1983 and income statements and balance sheets for 1982. He made no other records available to her. Because Ms. Raeihle believed that Mr. Freedman was being uncooperative, she recommended to petitioner that he obtain another accountant.

15. In April 1984, petitioner hired David Scott as his accountant. Mr. Scott met briefly with auditors from the Division, but he was not involved in their audit. After the notice of determination was issued, he obtained some of petitioner's records from the New York State Attorney General's Office and other records from Mr. Freedman, and he used these records to conduct his own analysis of petitioner's tax liability.

16. At his sentencing hearing, the Court instructed petitioner and his representatives to meet with the Division to see if they could agree on the exact amount of tax due. No agreement was reached. Following a hearing, the Court ordered petitioner to make restitution in the amount of \$87,069.90. This was an amount which petitioner had conceded was owed to the State.

17. The restitution amount was based on an analysis of petitioner's books and records made by David Scott. He arrived at this figure, primarily, by subtracting from the Division's estimate of audited gasoline sales certain sales attributable to alleged purchases from two particular suppliers, Kenneth B. Moyer Petroleum Products, Inc. ("Moyer") and Peterson Petroleum, Inc. ("Peterson").

18. Mr. Scott reviewed all Moyer and Peterson invoices and identified those he considered to be unreliable. His criteria for making this determination were based upon petitioner's description of his business practices. Petitioner told Mr. Scott that only petitioner, his sons and one other employee were authorized to sign for gasoline deliveries. Typically, the Moyer and Peterson invoices relied on by the Division were signed by employees purportedly not authorized to do so; many did not show exact meter readings; and some lacked a heading showing the name of the seller. Petitioner and Mr. Scott considered all such records to be unreliable.

19. Mr. Scott determined that petitioner owed sales tax of \$87,069.90 for the audit period.

(a) Mr. Scott aggregated all purchases from those invoices he considered unreliable for each month in the audit period. The selling price calculated by the Division was applied to these purchases. The resulting estimate of gasoline sales attributable to the questioned invoices and to purported arithmetic errors by the Division was \$6,555,585.90.

(b) Mr. Scott determined that the Division had made several calculation errors in its estimate of cigarette, kerosene and miscellaneous sales. On this basis he calculated a reduction in audited taxable sales of \$97,225.75. This was in addition to other adjustments agreed to by the Division (see ___ Finding of Fact "4").

(c) The Division's calculations show that additional taxable sales, after adjustments agreed to by the Division, amounted to \$8,822,803.37 plus additional tax due on the amount of \$17,945.71, representing purchases of capital assets. Mr. Scott calculated "additional sales per audit" as \$8,829,559.11. The discrepancy in the calculations was not explained.

(d) Mr. Scott calculated additional taxable sales of \$2,176,747.46 by subtracting the adjustments he calculated for gasoline and other sales from "additional sales per audit" of \$8,829,559.11. The tax due on these claimed additional sales was \$87,069.90.

20. Based on his review of petitioner's records, Mr. Scott believes that Mr. Freedman calculated gross sales on the basis of bank deposits. This method, by failing to take into account cash purchases made from gross receipts before those receipts were deposited, would result in an understatement of sales.

21. Petitioner made gasoline purchases from cash, and all of his purchases from Peterson and Moyer were made in cash.

SUMMARY OF PETITIONER'S POSITION

22. Petitioner contends that certain of the Moyer and Peterson invoices were at least unreliable, if not falsified, and he argues that those invoices cannot form the basis of a reasonable assessment. As evidence of their unreliability, he offered these facts: (a) the invoices were unsigned or signed by employees purportedly not authorized to accept gasoline deliveries; (b) meter readings did not appear on the invoices, which was contrary to petitioner's normal practice of inspecting all trucks and their meters and comparing these readings with the invoices before

accepting delivery; (c) Moyer and Peterson have been accused by other gas station owners of questionable business practices; and (d) Mr. Freedman was the accountant for Moyer and Peterson.

23. Petitioner maintains that he pleaded guilty to a single count of filing a false instrument in the first degree in order to avoid continued physical and mental stress and humiliation to his family and to himself.

24. It is petitioner's position that he reasonably relied on his accountant of 13 years who was totally responsible for preparing all tax returns, and petitioner maintains that he did not knowingly fail to pay any taxes due to the State.

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides, in pertinent part, as follows:

"If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission from such information as may be available. If necessary, the tax may be estimated on the basis of external indices...."

B. In view of petitioner's failure to maintain records of individual sales as required by Tax Law § 1135 and the enormous discrepancy between petitioner's purchase records and those of his suppliers, the Division was warranted in concluding that petitioner's records were inadequate to verify taxable sales and in proceeding to estimate those sales on the basis of third party verification of petitioner's purchases. The burden then was upon petitioner to show by clear and convincing evidence that the audit methodology was unreasonable or that the results obtained were erroneous (Surface Line Operators Fraternal Organization v. Tully, 85 AD2d 858).

C. Petitioner has failed to carry his burden of proof. It is his position that the Moyer and Peterson invoices are so unreliable that the results obtained through their use must be rejected. This contention is not supported by the evidence. The invoices are not unreliable on their face. They are dated and signed by employees of petitioner, and the majority bear the name or initials of the driver making the delivery. Other than his own testimony, petitioner presented no evidence which would show that those invoices were false. Mr. Scott did not perform an independent analysis of petitioner's books and records; rather, in eliminating the Moyer and Peterson invoices from his calculations, Mr. Scott relied entirely on petitioner's assertion that the invoices were inconsistent with petitioner's typical business practices. Those facts offered by petitioner to cast doubt on the authenticity of the invoices were not sufficient to establish their unreliability by the standard of clear and convincing evidence. Petitioner presented no evidence regarding the kerosene, cigarette and miscellaneous sales which also contributed to the assessment. In conformance with the agreement reached at the Tax Appeals conference, the assessment is reduced to \$354,347.83 and is otherwise sustained.

D. During the years in issue, Tax Law § 1145(a) (former [2]) provided:

"If the failure to file a return or to pay over any tax to the tax commission within the time required by this article is due to fraud, there shall be added to the tax a penalty of fifty percent of the amount of the tax due".

E. At a hearing, the burden is placed on the Division to establish "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing" (Matter of Walter Shutt and Gertrude Shutt, State Tax Commission, June 4, 1982).

F. The Division has sustained its burden of proof regarding the fraud penalty imposed. In arriving at this conclusion, no single fact among those established at hearing was considered conclusive. However, all of the facts, taken together, evidence a knowing, willful and deliberate attempt by petitioner to evade payment of taxes lawfully due.

Despite his lack of formal education, petitioner was an experienced and successful businessman. He operated the car wash and gas station for 18 years. During that time, he renovated and expanded his business to include a convenience store. The volume of his business was substantial. During the audit period, petitioner reported sales of \$5,500,000.00 (see ___, Matter of Richard Cocilova, State Tax Commission, February 24, 1987). Petitioner admitted that he failed to report over \$2,000,000.00 in gross sales in a period of approximately 36 months, and he attempted to attribute this underreporting to his accountant's negligence. It is difficult to believe that such a large sum went unnoticed by petitioner. Furthermore, there was substantial evidence that the degree of underreporting was much greater than even that admitted to by petitioner (see ___, Matter of Cardinal Motors, State Tax Commission, July 8, 1983). While petitioner is collaterally estopped from contesting the civil fraud penalty only for that period to which he entered a plea of guilty to the criminal charge (see ___, Plunkett v. Commissioner, 465 F2d 299 [7th Cir 1972]), the plea of guilty may be viewed as an indication of fraudulent intent (see ___, Cardinal Motors, supra). At the hearing on his plea, petitioner explicitly admitted providing his accountant with incomplete records with the intent of defrauding the State. This testimony was consistent with testimony at hearing establishing that petitioner provided his accountant with all documents used by the accountant, or members of his firm, to prepare the sales tax returns. Taken together, these facts establish by clear and convincing evidence that petitioner acted with a fraudulent intent to evade taxes lawfully owed to the State.

G. The petition of A. Charles Cinelli is granted to the extent indicated in Conclusion of Law "C"; the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued on August 13, 1985 shall be modified accordingly; and in all other respects, the petition is denied.

DATED: Albany, New York
September 1, 1988

ADMINISTRATIVE LAW JUDGE